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Treasury Chambers, Parliament Street, SW1P 3AG

The Hon Adam Butler MP
 Minister of State for Defence Procurement
 Ministry of Defence
 Main Building
 Whitehall
 London
 SW1A 2HB

6 February 1985

INERTIAL NAVIGATION SYSTEM FOR HARRIER GR5

A decision on whether to buy Litton or Ferranti inertial navigation systems has been under consideration since last summer; you and I discussed it in December. I am writing now to let you know the conclusion that I have reached in the light of discussion between our officials.

My concern was originally, as you know, that the more expensive, yet to be developed, Ferranti equipment was being chosen in preference to cheaper, well proven Litton equipment. Purchase of the Ferranti equipment could not have been justified on value for money grounds. Had UK manufacture been essential for wider reasons Litton should not have been invited to tender.

Several factors have now changed. In particular, Ferranti have reduced their price, and the exchange rate has fallen. The through-life costs of the two sets of equipment are now much the same, and I understand that your Accounting Officer is no longer able to point to either option as being preferred on defence budget grounds.

Your officials have assured mine that the risks involved in developing the equipment are small, that any delay would be unlikely seriously to affect the GR5 programme, and that Ferranti have agreed to an exceptionally heavy liquidated damages provision in the proposed contract.

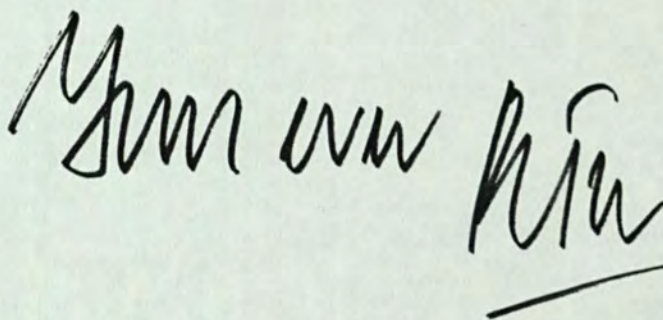
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On strict value for money grounds the Litton bid, offering proven equipment at about the same price, might still be better than the Ferranti bid. But the difference at current exchange rates is not significant. In these changed circumstances, I am content to leave the decision to you and would not object if you decided in favour of Ferranti.

If you do so decide, I hope that in telling Litton that their bid has failed care will be taken not to leave them with the impression that they were invited to tender merely to force down the UK bid (although this has been the result). It is important, in the interests of the defence budget, that overseas firms which compete for MOD contracts should genuinely be able to regard the competition as bona fide. The fall in the exchange rate should be an explanation for the present decision which Litton will understand.

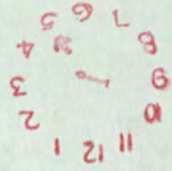
I am copying this letter to the Prime Minister, OD colleagues, George Younger and Sir Robert Armstrong.

A handwritten signature in black ink, appearing to read 'Peter Rees', written in a cursive style. The signature is positioned above the printed name 'PETER REES'.

PETER REES

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Defence Procurement : Pt 2



7 FEB 1985



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From the Minister of State
for Industry and Information Technology

GEOFFREY PATTIE MP

Rt Hon Adam Butler MP
Minister of State for
Defence Procurement
Ministry of Defence
Main Building
Whitehall
LONDON SW1

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9th January 1985

Dear Minister,

INERTIAL NAVIGATION SYSTEM FOR HARRIER GR5

I have been following the correspondence between you and Peter Rees with particular interest following our earlier discussion on the selection of an inertial navigation system for the Harrier GR5. I have also seen George Younger's letter of 21 December.

My interest arises not simply from my previous involvement in this subject when I was at the MOD, but also from the important trade and industrial aspects of the case which need to be taken into account. The main danger I see is that failure by Ferranti to win this order would not simply mean a loss of the work in question, but would also put at risk the company's credibility in international markets where their performance to date has been remarkably good. This is not a case of special pleading on behalf of a company which is uncompetitive internationally.

That said, I accept in principle Peter Rees' point that for competitive tendering to remain a credible method of procurement, the results of competition should determine the award of contracts. It is important therefore that the two areas of greatest uncertainty - the PDS costs and the exchange rate assumptions - are dealt with thoroughly and clearly in the paper for the OD meeting. This is particularly important for the PDS costs where serious doubts exist as to the validity of the American figures. But if the cost difference on the best estimates turns out to be marginal, then it would surely be perverse not to give the order to Ferranti. As George Younger suggests, the Treasury's procurement guidelines specifically allow broader and longer term considerations (such as the need to preserve competition for the future) to be weighed in the balance.

JAL/JALABG



Given the sensitivities this case has raised, I should be grateful if your officials would let mine see the paper for OD in draft, as suggested in Peter Rees' letter of 19 December.

I am copying this letter to the Prime Minister, members of OD, Peter Rees, George Younger and to Sir Robert Armstrong.

Yours sincerely,

Timothy Abraham

RP.

GEOFFREY PATTIE

*(Approved by the Minister
and signed in his absence)*

DEFENCE : Procurement : Pt 2.

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Treasury Chambers, Parliament Street, SW1P 3AG

Dr A S Kemp
PS/Minister of State for Defence Procurement
Ministry of Defence
Main Building
Whitehall
London SW1A 2HB

21 December 1984

Dear Dr Kemp

INERTIAL NAVIGATION SYSTEM FOR HARRIER GR5

The Minister of State for Defence Procurement spoke on the telephone to the Chief Secretary on 19 December about the choice between letting the contract for this work to the US company Litton or to Ferranti. The Chief Secretary wrote that day summarising the outcome of their conversation. He has asked me to write separately recording the points made in the discussion.

The Minister of State suggested that the Ferranti tender would be the cheaper, so far as initial procurement costs were concerned, if 116 sets were eventually purchased. He agreed, however, that on the basis of the firm requirement for 69 sets, for which the contract was to be placed now, the Litton tender was the more advantageous. The Chief Secretary said that he understood that if through-life costs were taken into account, as they must be, the Litton tender was cheaper if either the lower or the higher number of sets was bought. He asked the Minister of State about the advice of the MOD's Accounting Officer, and the Minister of State said that it was to the effect that the Litton tender represented better value for money. The Minister of State said he did not regard employment considerations as a major factor in deciding which tender to accept. But he was concerned that the UK should retain the defence industrial capacity to undertake the work involved in this contract and in his opinion it was essential, for this reason, to award the contract to Ferranti.

The Chief Secretary said that if defence industrial capacity was the overriding consideration, Litton should not have been invited to tender. Since they had been, not once but twice, he saw no alternative but to accept the better tender - i.e. from Litton. Not to do so could have repercussions for relations with the USA generally, and particularly on the willingness of

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US companies to tender in the future for UK contracts. There could also be an adverse effect on the prospects of British companies winning US business. Projects which might be offered included Forward Looking Radar (British Aerospace) and Head-up Displays (GEC - Marconi) for which more substantial sums were at stake.

As the Chief Secretary recorded in his letter of 19 December, he and the Minister of State concluded that the question of which tender to accept needed to be considered further by other Ministers concerned, probably in a meeting of OD Committee. They have asked officials from the departments concerned to discuss a suitable paper which might go to OD as soon as possible in the New Year.

I am copying this letter to the Private Secretaries of member of OD and to John Graham (Scottish Office) and to Richard Hatfield (Cabinet Office).

Yours sincerely
Richard Broadbent

R J BROADBENT

COMMERCIAL IN CONFIDENCE



SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

21 December 1984

Dear Chief Secretary

INERTIAL NAVIGATION SYSTEM FOR HARRIER GR5

attached

Thank you for sending me a copy of your letter of 19 December to Adam Butler. I am glad that this matter is now to be considered by OD and my officials stand ready to contribute to the paper when they see the MOD draft.

As you know, I have been taking a close personal interest in this matter. I very much hope that the postponement of our substantive discussion will allow 3 important points that have been causing me some considerable concern to be clarified before any paper for OD is finalised.

First, I noted that the fact sheet circulated for the proposed meeting on 19 December included sterling figures for the Litton bid that were based on an exchange rate of \$1.29 and which would not be held if the exchange rate fell below \$1.20. In contrast I understand that the papers considered at an earlier stage by officials had also a variant set of sterling figures with the exchange rate at \$1.20. I am sure you will agree that it is most unwise to limit the facts available to the Committee to a single assumption about the exchange rate, and what is more one which is already invalidated.

Second, I note that the fact sheet postulated that Ferranti's PDS costs after the first 2 years would be similar to the £250,000 applying to the first two years. Ferranti have more than once impressed on my officials that the true figure would be £60,000 per year and that this is the figure they have conveyed to MOD. Conversely, I note that the Litton figure for PDS costs is dismissed by MOD officials as too low but that no reasonable estimate is given in its place. I also note that Litton are apparently unwilling to be bound to any particular figure even though Ferranti's estimate for the first 2 years is a firm one. I fully appreciate that we cannot reasonably ask the companies to commit themselves to a particular figure for PDS charges through the life of such a long-lived contract. However, I am sure that we need very good grounds before departing so far from Ferranti's estimate, that we need to be quite clear that the Litton estimate is calculated to the same basis as the Ferranti estimate, that we need to be confident Litton's figure is credible, and that we fully understand the reason for any remaining difference between

the PDS figure.

Third, I believe we need to keep at the forefront of our minds the terms of the Treasury's procurement guidelines. Though these, of course, and quite properly give a great emphasis to costs, they also make it clear that costs are not the sole element in procurement matters. I fully share Adam Butler's view that it is important to keep in Britain an indigenous capability in inertial navigation, but more generally I was disturbed at the apparent rejection in your letter of the view that industrial matters were relevant to procurement issues. When the matter is as finely balanced as in this case, indeed so finely balanced that the decision appears to hang on a number of unquantified imponderables, questions of the industrial consequence of our decision must weigh particularly heavily.

I am copying this letter to the Prime Minister, OD colleagues, Adam Butler and to Sir Robert Armstrong.

Yours Sincerely

Shirley McCabe

Approved by the Secretary of State
and signed in his absence



Treasury Chambers, Parliament Street, SW1P 3AG

The Hon Adam Butler MP
 Minister of State for Defence procurement
 Ministry of Defence
 Main Building
 Whitehall
 London SW1

19 December 1984

Adam Butler

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INERTIAL NAVIGATION SYSTEM FOR HARRIER GR5

I am writing to record how we left matters following our telephone conversation this morning about the competition between Ferranti and Litton for the supply of this equipment.

You accepted, and confirmed that this was your Accounting Officer's advice, that the Litton tender offered better value for money. But you explained that you still wished to let the contract to Ferranti, primarily on the grounds that keeping this capability at Ferranti would be of value to the UK defence industrial base.

I found this difficult to accept because Litton had been invited to tender, not once but twice. Apart from considerations of good faith, refusing to abide by the outcome of a competition which Litton had clearly won could have damaging consequences for other UK defence manufacturers' prospects of securing business in the US. There is the further point that US firms will be loth to tender for MOD contracts if they do not believe that our competitions are genuine.

Since the interests of other departments are involved, we agreed that the best course would be for Michael Heseltine to circulate a paper to OD, to be taken as soon as possible. I suggest that your officials should now show mine a draft paper for clearance, which might also go to officials of the FCO, DTI and Scottish Office.

I am copying this letter to the Prime Minister, OD colleagues, George Younger and to Sir Robert Armstrong.

Peter Rees

PETER REES